Chevron U.S.A. Inc.
935 Gravier Street
New Orleans, Louisiana 70112
Tel 504 592 6726
Fax 504 592 7069
KeithCouvillion@chevrontexaco.com

J. Keith Couvillion
Land Consultant

CHEVRONTEXACO

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Department of the Interior
Minerals Management Service
Mail Stop 4024
381 Elden Street
Herndon, Virginia 20170-4817

Attention: Rule Processing Team

Re: Relief or Reduction in Royalty Rates – Deep Gas Provisions
68 Federal Register 14868-14886 (March 3, 2003)

Ladies and Gentlemen:

Chevron U.S.A. Inc. (CUSA) welcomes the opportunity to comment on the Minerals Management Services (MMS) proposed rulemaking covering the suspension of royalties for leases located in shallow waters of the Gulf of Mexico associated with deep gas drilling. CUSA is one of the largest leaseholders and platform operators in the Gulf of Mexico. We are very encouraged by MMS' proposed rule to stimulate deep gas production on the continental shelf and appreciate the opportunity to provide comments on the proposed rule.

MMS has requested interested parties comment on the proposed rule and provide answers to various questions asked in the preamble of the proposed rule as published in the federal register. To assist MMS is evaluating our comments we have divided our comments into two sections. The first section attempts to provide answers to some of MMS questions found in the preamble. The second section highlights the modifications to the proposed text of the rule we recommend MMS consider. Hopefully this format will make reviewing our input easier.

Comments on Preamble Questions:

Below you will find a list of questions found in the preamble of the proposed rule. Our comments and answers to these questions are as follows:

1. MMS is soliciting comments on two other RSV levels. Option B would provide 10 BCF for wells 15,000-18,000 feet deep, and 25 BCF for wells >18,000 feet deep. Option C would provide 10 BCF for wells 15,000-18,000 feet deep, and 20 BCF for wells >18,000 feet deep.

Comment: As highlighted in the preamble, royalty relief incentive volumes that will cause an increase in drilling activity are difficult to determine. Average field size distributions in shallow waters of the Gulf of Mexico, geological prospect type, size and risk, drilling challenges and product pricing are all factors in the decision process to drill or not. The incentive volumes proposed by MMS are considered reasonable and are of an amount to positively impact the decisions being contemplated by lessees to drill deep gas prospects. More or less volumetric incentives will have a similar effect on a lessee's decision to move forward in drilling a deep gas well with larger incentives having a greater positive effect on those decisions. Since each prospect is unique, quantifying a generic suspension volume which would apply to most drilling decisions is difficult and we believe the approach and amount of royalty suspension volume proposed by MMS is adequate.

2. To help us assess the validity of this inference, MMS would like responses to the following question: In comparison to the proposed approach, under what conditions would a royalty suspension volume or supplement allocated among several leases within a unit result in either more deep drilling or less administrative burden?

Comment: If the purpose of this proposed rule is to stimulate deep gas drilling in the Gulf, drilling the best opportunities sooner than later would be preferable. Under any unit scenario the objective is to drill and develop common geological features that underlie multiple leases. To eliminate unnecessary drilling, the best drilling locations within the unit are selected and drilled. Drilling unnecessary wells is reduced, if not eliminated. Under the provisions stated in the proposed rule, an argument can be made that MMS is promoting the drilling of unnecessary wells in order for lessees to preserve royalty relief for all leases in a unit. As an example, if a four-lease unit exists with a recognized undrilled deep (20,000') prospect, the unit owners would pursue drilling this deep prospect from the best surface location to reach the best bottom hole objective. Should the well result in a commercial discovery and qualify for royalty relief, only the lease where the well is completed would actually receive any royalty relief. Until the other three leases in the unit were drilled, they would not be entitled to any royalty free production on any portion of their allocated share of production. Without having the right to share in the royalty relief, lessees are being encouraged to drill unnecessary wells to earn royalty relief.

It is anticipated deep gas wells will encounter geological pressures that will allow large geographic areas to be drained assuming reservoir sands are contiguous. If in fact high pressures are encountered, only a few wells will be necessary to efficiently drain these reservoirs. If these wells were drilled on only two of the four leases in the unit, and assuming these wells were successfully qualified deep wells, the undrilled leases in the unit would not be entitled to royalty free production on production allocated to them. It is recommended MMS consider allowing royalty suspension volumes be granted to all undrilled leases in a unit when, for the prevention of waste and the conservation of the natural resource, a limited number of wells are necessary to

develop a new deep gas discovery. We have suggested some language in the proposed rule to address this issue and allow a mechanism for MMS to grant royalty relief on undrilled leases in a unit. We do not believe taking the approach will increase MMS' administrative burden substantially.

3. **Sidetracking**

Comment: Sidetracking existing well bores is a very common practice followed in the Gulf of Mexico. With approximately 3500 platforms in existence, the likelihood of utilizing a previously drilled well bore to drill new deep test is high. If a deep gas well can be mechanically drilled using an existing well bore, the well should be drilled using the well bore. There are many cases where the existing well bore design will not allow the efficient or effective sidetracking to a deep geological target; however, there are other situations where an existing well bore could be utilized.

The MMS slide show presentation at the April 30, 2003 workshop defined a sidetrack as (a) a well drilled to a different target reservoir than an original new well or (b) a well deepened to a new target. The implication is that any well in which a plug or whipstock is set and the well subsequently drilled to a different bottom hole location with a target in the same original objective reservoir, would be classified as a bypass. However, NTL 2000-N07 and the MMS Production Districts differ on this matter.

NTL 2000-N07 defines a bypass as "a remedial drilling effort in which portions of a hole are redrilled around junk (i.e. lost tools, pipe, or other material blocking the hole), "lost holes" are redrilled, or "key seats" or "crooked holes" are straightened. This is also called a mechanical sidetrack."

NTL 2000-N07 defines a sidetrack as "a drilling effort in which an additional hole is drilled leaving a previously drilled hole at some depth below the surface and above the total depth. A whipstock or plug is set in the previously drilled hole, which is the starting point for sidetracking operations. The drilling of a well after a slot reclamation (which previously had a well) is considered a sidetrack. This section of a hole drilled to a new objective bottomhole location is considered a sidetrack. This is also called a geologic sidetrack."

The definition of sidetrack in NTL 2000-N07 results in a new well being disqualified from royalty relief if drilled from a reclaimed surface slot since it would be classified as a sidetrack. From the apparent intention of the proposed rule, it seems reasonable that a new well drilled from a reclaimed slot should qualify for royalty relief and not be disqualified. A well drilled from a reclaimed slot would exceed the cost of a new well drilled from an open slot on a platform due to the added cost to reclaim the slot needed to drill the well.

In addition, the NTL 2000-N07 definition of a sidetrack results in disqualification from royalty relief in the case of a sidetrack to a new location in the original objective reservoir because the NTL definition of a sidetrack does not distinguish between whether or not the new objective

bottomhole location is in the original objective reservoir or a different objective reservoir. For example, if a new well encounters a gas/water contact at a location down dip to the targeted objective reservoir, and the lessee believes sufficient potential exists up dip to potentially justify development, sidetracking the well to an up dip location for the purpose of targeting the objective reservoir in a better location would result in the sidetrack (as defined by the NTL) being disqualified from royalty relief even though this operation would be the most prudent to pursue.

As for the MMS Production Districts, one District has advised that a well is a sidetrack if a plug or whipstock is set in an existing well bore and the well is then drilled to a new objective bottomhole location more than 100' from the original objective bottomhole location, regardless of whether or not the new objective bottomhole location is or is not in the original objective reservoir. Another District advises that it would classify a well as a bypass if sidetracked to a new location in the original objective reservoir under most circumstances. The classification of a well as a sidetrack or a bypass occurs in the District.

It is clear that the MMS seeks to encourage the search for deep gas on the shelf of the Gulf of Mexico. There are many cases in which a new deep well can only be justified if there is the opportunity to further sidetrack that new well to test another objective deep reservoir(s), whether to verify sufficient reserves to justify development or to attempt to salvage an initial deep dry hole through a sidetrack.

MMS should encourage, not discourage, the use of existing wells to drill, develop and produce deep gas opportunities. As stated earlier, the primary purpose of this proposed rule is to encourage deep drilling on the shelf. By categorically eliminating sidetracking operations, MMS is excluding one of the most viable options for exploring deeper for new gas reserves.

To help us evaluate the possible significance of deep sidetracks, we would like responses to the following questions included in comments:

- When and how often is drilling a sidetrack used to explore a new reservoir rather than to supplement an original development or delineation well, and is the situation different by drilling depth?

  Answer: Many factors are considered when drilling new opportunities from existing facilities. If a slot is available, or an idle well can be used, utilizing the slot or idle wellbore makes economic sense under certain scenarios. Wells drilled from existing platforms usually can be placed on production sooner than remotely drilled wells. The economics of a project are enhanced if production is flowing sooner than later. Drilling depth, among other factors, are important elements in the decision process whether or not to sidetrack an existing well or drill a new one. The facts surrounding the prospect ultimately provide the direction on the decision to be made how to drill the opportunity.

- How important is sidetracking to a deeper depth in comparison to sidetracking in shallower pay zones, and why?

Answer: Being able to sidetrack existing wells to deeper depths is very important. One of the biggest challenges we face when drilling wells deeper than existing field pays is depleted zones. It is a challenge for us to design a well program to compensate for the change in geological pressures encountered when drilling in a field where hydrocarbons have been produced and certain sand segments are of a significantly different formation pressure than the formations above and below the depleted zone. If an existing wellbore can be used that has depleted zones isolated and behind casing, drilling cost can be saved and mechanical risk associated with drilling the well can be reduced. Whether sidetracking deeper or shallower, compensating for depleted zones in existing fields is a major issue of concern. Sidetracking is and economic and risk reducing viable alternative in addressing the depleted zone challenge.

- Would the proposed relief program distort decisions in favor of more costly new deep wells instead of less expensive deep sidetracks? If so, how serious and/or extensive would this effect be?

  Answer: There is the possibility the proposed royalty relief program could distort the decision making process in deciding what approach should be used to drill deep gas opportunities on the shelf. Normally when evaluating how to drill deep prospects all option are considered. If an existing well can be used, and it makes economic sense to reclaim a slot and sidetrack or deepen the well, the sidetracking option would normally be pursued. If the mechanical risk is too high, or the casing in the well is inappropriate for the well being considered, drilling a well off the existing platform or from an empty slot on the platform is the option that will be considered. Categorically eliminating sidetracking operations from royalty relief consideration could cause lessees to drill new wells as opposed to sidetracking existing ones. The economic value of one option verses the other would be a major factor in the decision process. As stated earlier, every project is unique and the facts of the opportunity being considered directly effects the action ultimately taken.

To help us evaluate these and other options, we would like responses to the following questions included in comments:

- To what extent does the absence of royalty relief for sidetracks adversely affect deep depth drilling and distort the choice between the types of wells drilled?

  Answer: An argument can be made that by automatically excluding sidetracking operations from the royalty relief program, MMS is categorically eliminated a common drilling option routinely considered by industry. There could be situations which arise were drilling a sidetrack well is the only viable option available. A lessee may forgo the opportunity because royalty relief is not available and the opportunity is too costly and risky to pursue.

  If a subset of deep sidetracks were to receive a royalty suspension volume:
  -Should we limit the incentive to sidetracks that achieve a minimum offset distance?

  Answer: We would not recommend pursing royalty incentives tied to offset drilling distances. We are not sure how an incentive program would be structured under this type of

drilling scenario.

-If so, what is the proper minimum offset distance and why is this offset distance appropriate?

Answer: Same as above. We would not recommend pursing royalty incentives tied to offset drilling distances. We are not sure how an incentive program would be structured under this type of drilling scenario.

-Should we limit the incentive to a sidetrack from a new well that is drilled after the publication date of this proposed rule? Why?

Answer: We support the application of the proposed rule to sidetracking operations. To us it is reasonable to allow sidetracking operations to be considered for royalty relief in wells drilled before and after the publication date of the proposed rule. Our preference is to have the same royalty incentives apply to all sidetracking operations; however, considering the complexities associated with designing a royalty relief program applicable to all sidetracking possibilities, we have proposed modifying the text of the rule, as shown below, to offer a compromise to MMS.

- Should we limit the incentive to a sidetrack from a deep well as opposed to a shallow well? Why?

Answer: No. The incentive should apply to both deep and shallow sidetracking operations. As stated earlier, the intent of the new rule is to encourage the drilling of deep gas wells on the shelf. By limiting which deep wells are entitled to the incentives, MMS would be promoting an activity that is contrary to the intent of the proposed rule.

- Should a single royalty suspension volume be set based on the relative average costs of sidetracked deep wells in comparison to new deep wells?

Answer: No. Well cost vary significantly based on many factors. Tying royalty relief to a meaningful generic cost figures would be extremely difficult if not impossible. There are too many variables that affect the cost of deep sidetracked wells. In many instances the cost and risk associated with drilling and completing a deep sidetrack well are significantly greater than drilling a straight hole.

- What other elements should we consider in determining the royalty suspension volume if we decide to employ different ones for new deep sidetracks and for new deep wells?

Answer: As a general rule sidetracking operations are less costly than straight or directional wells drilled from the surface (new wells). On a total cost drilled basis statistics support this assumption. If well cost was the most critical variable used by MMS in determining royalty relief volumes proposed in the rule, reduced well cost would logically equate to reduced royalty relief volumes. As reflected in the text changes proposed below, our recommendation is that royalty suspension volumes be reduced when a certain categories of sidetracking operations result in a successful qualified deep well being drilled.

- Should the size of the royalty suspension volume vary with the offset distance of a sidetrack or should there be a single volume for deep sidetracks? Why?

Answer: We would recommend MMS not vary the royalty suspension volumes by offset distance but consider the reduced royalty relief option as described below in the text changes suggested to the proposed rule.

- Does the cost of a sidetrack increase per extra foot drilled relative to that of a straight hole?

Answer: As stated above, many variables affect the cost of drilling wells in the OCS. Well costs may be greater for a sidetracking operation than a straight hole and vice versa. As a general rule however, our statistics indicate sidetracking drilling operations are less expensive than conventional straight holes all things being considered.

- Should the royalty suspension volume for sidetracks apply to only the very deep total depths (18,000 feet TVD SS or deeper)? Why?

Answer: No. As stated above, the intent of the proposed rule is to encourage drilling and not discourage it. Royalty relief should apply to both shallow and deep drilling and completion operations.

- Should sidetracks receive the same, different, or no royalty suspension supplement as new wellbores drilled to very deep total depths (18,000 feet TVD SS or deeper)?

Answer: We would recommend MMS allow the same royalty suspension supplement for sidetracks as "new wells" in the event royalty suspension is granted for sidetracks in the final rule.

- What size supplement would be effective and efficient in the program for drilling unsuccessful sidetrack wells?

Answer: We recommend the same size supplement be allowed for sidetracking operations as is provided for unsuccessful wells drilled below 18,000'. The 5 BCF supplement is viewed as a way to minimum the adverse impact of drilling a non-commercial deep well. In most cases the value of the royalty not beginning paid will only cover a portion of the cost of drilling the non-commercial well. We would recommend MMS consider allowing the 5 BCF supplement remain at the same level whether a well is drilled below 18,000' by sidetracking operations or in a new well operation.

- In addition to the API survey, are there any other publicly available sources that offer data on deep sidetrack drilling costs?

Answer: Not that we are aware; however, there is a private service that tracks most Gulf of Mexico drilling operations including sidetracks and captures cost and general drilling information. This service is referred to as the Dobson Database. Dobson includes public data of all operators but cost data is available only from the +/- 20 operators who actually participate in contributing that information to Dobson. Cost data for 40% of all sidetracks and 47% of all new drills is available through the Dobson Database. Lessees subscribe to this service. To learn more about the database, please contact Mr. Ted Dobson with James K. Dobson Company. He can be reached by phone at 800-275-0439 (Fax 817-0488-4273),

by mail at P.O. Box 1419, Grapevine, Texas 76099, or by e-mail at email@infogulf.com.

4. **Auction Mechanism**

MMS would like to solicit comments on an alternative mechanism to allocate royalty relief for existing leases. This approach will not be pursued for this rulemaking, but may be pursued for future allocations. MMS would like to solicit comments on the feasibility of this approach, as well as solicit inputs on alternative approaches to make the allocation of royalty relief more efficient. This approach would seek to allocate approximately the same total royalty relief, but would differ in that not all lessees would receive the same relief, with the objective of encouraging greater levels of overall drilling at lower or comparable Federal cost.

Comment: Applying royalty incentives to all leases and lessees is a fair and non-discriminatory way of encouraging drilling in the OCS. Implementing an auction method of allocating incentives would do nothing more than eliminate certain lessees from being able to compete for the incentives and ultimately could result in fewer wells being drilled. Under an auction procedure, potential lessees would bid for royalty relief, either through cash bonus bidding or with the royalty relief itself as the bid variable. We oppose such an approach, insofar as it would be prone to unintended and perverse consequences. Most importantly, the auction mechanism would defeat the purpose of the proposed rule, denying relief to those that potentially would need it most.

In regard to the five questions specifically asked by MMS regarding utilization of the auction process, we will refrain from commenting. We can only speculate as to the answers to the questions and are of the opinion that since in our minds the auction approach would be substantially inferior to the incentive program MMS has proposed, pursing an auction incentive program should be eliminated from consideration.

Comments on Proposed Rule:

Highlighted below, in the text of the proposed rule, are various suggested modifications for MMS consideration.

PART 203 RELIEF OR REDUCTION IN ROYALTY RATES

1. The authority citation for part 203 continues to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq; 30 U.S.C. 1001 et seq; 30 U.S.C. 1701 et seq; 31 U.S.C. 9701 et seq; 43 U.S.C. 1301 et seq; 43 U.S.C. 1331 et seq; and 43 U.S.C. 1801 et seq.

2. Section 203.0 is revised by adding definitions for "deep well", "new well," "participating area", "reservoir", "royalty suspension supplement," "sidetracking operations," *(Note: New definition)* "successful qualified deep well," and "unsuccessful certified well" in alphabetical order to read as follows:

§ 203.0 What definitions apply to this part?

* * * * *

Deep well means a well drilled and completed with a perforated interval, the top of which is at least 15,000 feet true vertical depth below the datum at mean sea level (TVD SS), or a well drilled and completed with a perforated interval the top of which is at least 18,000 feet TVD SS *(Note: Phrase added for clarification)*, or a well drilled but not completed to a target reservoir deeper than 18,000 feet TVD SS.

* * * * *

New well means a well drilled from a remote location on a lease, a well drilled from an open slot on a platform, caisson or well protector, a well drilled from a reclaimed slot on a platform, caisson or well protector, ~~that results from drilling that does not utilize,~~ a well deepened to a new deep reservoir, or a wellbore where sidetracking operations are conducted. *(Note: Language suggested would include sidetracking, deepening and slot reclamation operations for royalty relief consideration. See previous comments.)*

* * * * *

Participating area means that part of the unit area that is reasonably proven by drilling and completion of producible wells, geological and geophysical information, and engineering data to be capable of producing hydrocarbons in paying quantities.

* * * * *

Reservoir means an underground accumulation of oil or natural gas or both characterized by a single pressure system and segregated from other such accumulations.

* * * * *

Royalty suspension supplement means a royalty suspension volume generated from drilling an unsuccessful certified well and applied to royalties due on future royalty-bearing natural gas and oil production on, or allocated to, the same lease.

* * * * *

Sidetracking operations means a deep well utilizing, in part, a wellbore in existence prior to the drilling of the deep well and located on or off the lease. In addition, a sidetracking operation shall include the sidetracking of a new well when such sidetracking is necessary to further evaluate the original objective reservoir, or when sidetracking operations are conducted out of a new well or a sidetracking operation is conducted out of another sidetrack in the same new well, any such well bore which has not produced out of a completion in the original well bore or any of its prior sidetracks. *(Note: New definition to add sidetracking operations to the rule. See comments stated above for justification.)*

* * * * *

Successful qualified deep well means a new deep well completed on your lease:

(1) That begins drilling after March 26, 2003, and

(2) That begins producing natural gas, including gas associated with oil production before **[DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]** from a depth equal to or greater than 15,000 feet deep TVD SS, or *(Note: Added for clarity.)*

(3) That was drilling on the **[DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]**, and subsequently completed as a commercial well, or *(Note: Added to address the contingency of drilling a well through the expiration of the five year*

period.)

(4) That was drilled prior to the **[DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]** but is currently not producing pending the installation of appropriate production equipment. *(Note: Added to address the contingency of having a successful well on the lease that is not producing while waiting on a platform or other equipment necessary to produce the well.)*

* * * * *

Unsuccessful certified well means a new well drilled on your lease:

(1) Beginning after March 26, 2003,

(2) Beginning before **[DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE]**,

(3) Beginning before your lease produces, excluding test production, *(Note: Added for clarity and to eliminate any confusion regarding production associated with testing a well before actual commercial production commences.)* from a successful qualified deep well;

(4) To a depth of at least 18,000 feet true vertical depth below the datum at mean sea level (TVD SS);

(5) That targeted a reservoir identified by lessee or his designee *(Note: Places the burden on lessee to identify the target reservoir.)* from seismic and related data deeper than 18,000 feet TVD SS; and

(6) That fails to meet the producibility requirements of 30 CFR Part 250, subpart A, from depths equal to or greater than 18,000 feet TVD SS *(Note: Added for clarity.)* and does not produce, or that MMS agrees is not commercially producible from any depth equal to or greater than 18,000 feet TVD SS. *(Note: Added for clarity.)* (Any well producing from a reservoir 15,000 feet TVD SS or deeper is deemed a successful well, though not necessarily a successful qualified deep well. In addition, a well drilled to at least 18,000 feet TVD SS but completed only at a depth above 15,000 feet TVD SS will not disqualify the well from being classified as an unsuccessful certified well). *(Note: Added for clarity and to assist in eliminating any confusion regarding when the royalty supplement would be applicable.)*

* * * * *

3. A new undesignated heading and new §§ 203.40 through 203.48 are added to read as follows:

ROYALTY RELIEF FOR DRILLING DEEP GAS WELLS

§ 203.40 Which leases are eligible for royalty relief as a result of drilling deep wells?

Your lease may receive a royalty suspension volume under sections 203.41 through 203.43 and may receive a royalty suspension supplement under sections 203.44 through 203.46 if it:

(a) Was issued in an OCS lease sale held before January 1, 2001, or in a lease sale held on or after that date and the lessee has exercised the option under § 203.48, or a lease validated under Section 6 of the Outer Continental Shelf Lands Act of 1953, as amended *(Note: Added to include leases in the OCS not issued pursuant to a lease sale.)*;

(b) Is located in the Gulf of Mexico, wholly west of 87 degrees, 30 minutes West longitude ~~entirely~~ any portion of which is located *(Note: The word "entirely" was deleted, and the new phrase added to include all leases where any portion of the block is in water depths of 200*

meters. Adding this language will allow a few additional leases in the Gulf of Mexico to be subject to potential royalty relief for deep gas drilling. We consider this beneficial and should be included as part of the area being considered for incentives.) in water less than 200 meters deep; and

(c) Has not produced gas or oil, with the exception of test production, *(Note: Added for clarity and to eliminate any confusion regarding production associated with testing a well before actual commercial production commences.)* from a reservoir discovered in a *(Note: Phrase added to separate existing deep reservoirs discovered before March 26, 2003 from new deep reservoirs discovered after March 26, 2003. We do not believe it is the MMS' intent to exclude a lease from royalty relief consideration when, as an example, the lease has produced from 15,100' and the lessee has identified a new deep gas prospect existing at 22,000 feet. The intent of the rule is to encourage drilling the deep prospect.)* deep well that commenced drilling before March 26, 2003. New reservoirs discovered below existing or previously produced reservoirs located below 15,000 feet TVD SS would be eligible for royalty relief. *(Note: See comment above.)* Production before March 26, 2003 *(Note: Added for clarity.)* ~~that date~~ from a deep well on another lease on your unit does not make your lease ineligible for royalty relief.

§ 203.41 If I drill a successful qualified deep well, what royalty relief could I receive?

(a) Subject to the administrative requirements of § 203.43 and the price conditions in § 203.47, we will suspend royalties for the produced gas volumes, as reported in accordance with 30 CFR Part 216.53 (Oil and Gas Operations Report, Part A or OGOR-A), shown in the following table (in billions of cubic feet or BCF):

If you have a successful qualified deep well. . .	**then, we suspend royalties on this volume of deep gas production from or allocated to your lease as prescribed in this section and § 203.42:**
(1) From 15,000 to less than 18,000 feet TVD SS	15 BCF*
(2) 18,000 feet TVD SS or deeper	25 BCF*

* (Wells which were drilled as sidetracking operations or deepenings where a wellbore existing prior to March 26, 2003 was used, and the sidetracking operation or deepening was ultimately classified as a successful qualified deep well, shall be entitled to suspension of royalties for volumes of 10 BCF for wells completed between 15,000 feet to less than 18,000 feet TVD SS, and 20 BCF for wells completed at a depth of 18,000 feet TVD SS or deeper. For purposes of this reduced royalty relief allocation, new wells drilled from existing unused slots or reclaimed slots on platforms, caissons and well protectors shall not be subject to reduction in royalty relief, or shall sidetracking operations conducted in new wells drilled after March 26, 2003 be subject to this reduction in royalty relief.) *(Note: This language is suggested to allow the incentive to utilize existing well bores to encourage deep gas drilling earlier than later while adjusting the entitled royalty relief volume for the perceived reduction in drilling cost associated with using a part of an existing well bore.)*

(b)(1) The royalty suspension volume determined under paragraph (a) for the first successful qualified deep well on your lease establishes the total royalty suspension volume available for that lease. You will not receive an additional royalty suspension volume if you drill more successful qualified deep wells on your lease or if you later drill and complete a deeper well that would have qualified for a higher royalty suspension volume. For example, if you drill a successful qualified deep well to 16,000 feet TVD SS and later drill a second successful qualified deep well on the lease to 19,000 feet TVD SS, your total royalty suspension volume is limited to 15 BCF. If your lease is within an MMS-approved unit, see subparagraph (3) of this paragraph.

(2) After you receive a royalty suspension volume for your first successful qualified deep well, if you later begin production from another successful qualified deep well on the lease, or begin production from a well existing on the lease prior to the first successful qualified deep well, *(Note: Language added to ensure all available well bores could be utilized to produce new gas.)* you must notify MMS of that production under §203.43.

(3) This paragraph applies if your lease is within an MMS-approved unit.

(i) If the first successful qualified deep well on your lease is a well within a unit participating area, 100 percent of the royalty suspension volume available for that well under paragraph (1) of this subsection applies only to your allocated share of production from that well. No other lease in the unit is entitled to any of the royalty suspension volume under this section or §203.42, even though another lessee may be entitled to a share of the production from the successful qualified deep well on your lease. Your royalty suspension volume for the lease will not increase if your lease is entitled to an allocated share of production under the unit agreement from another deep well either on your lease or another lease in the unit.

(ii) If the first successful qualified deep well located on your lease was not a unit well, and if your lease is entitled to an allocated share of production under an MMS-approved unit agreement from another deep well within the unit participating area either on your lease or on another lease, that allocated share of production will not increase the volume of royalty suspension you qualify for under this section based on the first successful qualified deep well on your lease.

(iii) If you do not have a successful qualified deep well located on your lease, then you are not entitled to any royalty suspension volume for production allocated to your lease under the unit agreement from a successful qualified deep well on another lease in the unit.

(iv) Notwithstanding the provisions stated above, when a successful qualified well has been drilled within a unit, MMS will have the discretion to grant royalty suspension volumes in amounts equal to the suspension volume stated in § 203.41 for each lease included in the unit after determining a successful qualified well is not necessary to be drilled on each lease in the unit to efficiently develop the discovered reservoir. Should the MMS exercise this discretionary authority, the provisions of § 203.40, 203.41 and 203.42 shall apply to each lease in the unit granted a royalty suspension volume. *(Note: By adding this language to the proposed rule, MMS is given the discretionary authority to give all leases in a unit royalty relief without the necessity of drilling wells on each lease. Due to the fact many deep reservoirs contain high geological pressure fewer wells most likely will be needed to extract the recoverable hydrocarbons when reservoir sands are continuous. Maximizing recoverable reserves with the minimum number of wells drilled to prudent reservoir management. Requiring wells to be drilled on all leases in a unit to earn royalty relief promotes inefficient reservoir development.)*

(c) Any royalty relief allowed under paragraph (a) of this section is in addition to any royalty suspension supplement for your lease under § 203.44 that results from a different well bore.

(d) You must pay minimum royalties in accordance with your lease terms notwithstanding any royalty suspension volumes allowed under paragraph (a) of this section.

§ 203.42 To which production do I apply the royalty suspension volume from drilling a successful qualified deep well on my lease?

(a) This paragraph applies to any lease that is not within an MMS-approved unit. Subject to the requirements of §§ 203.40, 203.41, 203.43, 203.44, and 203.47, beginning on the ~~day~~ date of your letter where *(Note: Added for clarification and to eliminate any confusion as to the day royalty suspension begins to apply.)* you provide MMS the notice required under § 203.43, you must apply the royalty suspension volume to production from all successful qualified deep wells, or those existing wells capable of producing from the deep gas reservoir(s) drilled prior to the successful qualified deep well being drilled *(Note: This phrase has been added to cover the possibility of using existing well bores to participate in the extraction of newly discovered reserves found in new deep reservoirs. Some existing wells could be sidetracked to exploit a new reserve. The language is suggested to cover this contingency to not eliminate a viable option for efficiently developing newly discovered reservoirs.)*, on your lease for which you have given notice. Apply the royalty suspension volume applicable to your lease to that production each month until you use all of your royalty suspension volume.

(b) This paragraph applies to any lease all or part of which is within an MMS-approved unit and that has at least one successful qualified deep well located on the lease. Subject to the requirements of §§ 203.40, 203.41, 203.43, 203.44, and 203.47, beginning on the ~~day~~ date of your letter where *(Note: Added for clarification and to eliminate any confusion as to the day royalty suspension begins to apply.)* that you provide MMS the notice required under § 203.43, you must apply the royalty suspension volume to your share of production from all successful qualified deep wells, or those existing wells capable of producing from the deep gas reservoir(s) drilled prior to the successful qualified deep well being drilled *(Note: This phrase has been added to cover the possibility of using existing well bores to participate in the extraction of newly discovered reserves found in new deep reservoirs. Some existing wells could be sidetracked to exploit a new reserve. The language is suggested to cover this contingency to not eliminate a viable option for efficiently developing newly discovered reservoirs.)*, on your lease for which you have given notice, and to production volumes allocated to your lease from deep wells on other unit leases drilled after March 26, 2003. Apply the royalty suspension volume applicable to your lease to that production each month until you use all of your royalty suspension volume.

(c) Unused royalty suspension volume automatically (Note: Added for clarification and the let lessees know no action is require to transfer the unused volumes.) transfers to a successor lessee and expires with the lease.

(d) You may not apply the royalty suspension volume allowed under § 203.41;

(1) To production from a deep well drilled before March 26, 2003, unless the production is obtained after the drilling of a successful qualified deep well *(Note: Consistent with the thought that an existing well not qualifying as a successful qualified deep well initially but subsequently able to produce from deep reservoir encountered in a successful qualified deep well drilled later*

on the lease.);

(2) To production from wells less than 15,000 feet TVD SS;

(3) To deep production from any other lease, except as provided in paragraph (b) of this section.

(e) You must begin paying royalties when the cumulative royalty-free production of gas from or allocated to your lease reaches the applicable royalty suspension volume allowed under § 203.41. For the month in which cumulative production reaches this royalty suspension volume, you owe royalties on the portion of gas production that exceeds the royalty suspension volume remaining at the beginning of that month.

(f) All liquid hydrocarbon volumes are subject to royalty. This includes condensate recovered at separation facilities without processing. If you sell your gas before it is processed, the royalty suspension volumes apply to the gas production reported on the OGOR-A. If your gas is processed before you sell it, the royalty suspension volumes apply only to residue gas generated after processing and not to any natural gas liquids.

§ 203.43 What administrative steps must I take to use the royalty suspension volume?

(a) You must provide written notification to the MMS Regional Supervisor for Production and Development of your intent to commence drilling operations on deep wells; and

(b) Within 30 days of commencement of production that qualifies for royalty suspension, you must:

(1) Notify the MMS Regional Supervisor for Production and Development that production has commenced; and

(2) Request confirmation of the size of the royalty suspension volume that applies to your lease.

(c) You must meet any special production measuring requirements that the Regional Supervisor for Production and Development has determined are necessary under 30 CFR 250, subpart L for royalty suspension volume. You will be granted a temporary short term waiver to allow allocation of production between royalty bearing production and royalty relief production on a well test basis while you install the necessary facilities and metering to meet our desired surface commingling requirements. No special production metering requirements will be necessary for measuring a royalty suspension supplement *(Note: Added for clarification.)*.

(d) If you commenced drilling a successful qualified deep well after March 26, 2003 and produced it before **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]**, you must provide the information required by paragraph (b) on or after **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]** and no later than **[INSERT THE DATE 30 DAYS AFTER THE EFECTIVE DATE OF THE FINAL RULE]**.

(e) Should you fail to provide timely notice as provided under this § 203.43, MMS will have the discretion to deny your request for a royalty suspension volume. *(Note: Added to eliminate any confusion as to what would happen should a lessee fail to timely notify MMS of a pending deep gas well test.)*

§ 203.44 If I drill an unsuccessful certified well, what royalty relief could I receive?

(a) If you drill an unsuccessful certified well, and satisfy the administrative requirements of § 203.46, you will receive a royalty suspension supplement of five (5) *(Note: Added for clarity.)*

BCF for your lease, to be applied to subsequent production of gas and oil, as reported in accordance with 30 CFR Part 216.53 (OGOR-A), on or allocated to your lease as provided in § 203.45. The conversion from oil to gas for using the royalty suspension supplement is specified in § 203.73.

(b) You may receive royalty suspension supplements for up to two unsuccessful certified wells per lease. You may not receive more than one royalty suspension supplement from a single well bore.

(c)(1) If the same well bore used to qualify for a royalty suspension supplement later produces from a perforated interval the top of which is 15,000 feet TVD SS or deeper no later than March 26, 2003, it will become a successful qualified deep well. If the completion of this successful qualified deep well is on your lease, then you must subtract that portion of the royalty suspension supplement that has been applied to other production from the lease from the royalty suspension volume remaining for the lease. The difference represents the maximum royalty suspension volume for which you are eligible on the lease. ~~If the completion of this successful qualified deep well is on another lease, then the royalty suspension volume earned by this other lease must be reduced by the full amount of the royalty suspension supplement applied on your lease.~~ *(Note: This sentence was deleted due to the fact it is inconsistent with the rest of the rule and is suggested to be deleted. Royalty relief and supplement are being applied on a lease bases throughout the rule. This sentence states that a completion of a well on another lease would require reducing the royalty suspension volume on your lease where the completion was not made.)* You may not use any remaining unused portion of the royalty suspension supplement earned for that well bore. (2) Notwithstanding any other provision of this part, the total amount of royalty relief earned from or applied to production from a single well bore that originally qualified as an unsuccessful certified well, but that later produces, cannot exceed 25 BCF.

(d) You must pay minimum royalties in accordance with your lease terms notwithstanding any royalty suspension supplements under this section.

§ 203.45 To which production do I apply the royalty suspension supplements from drilling one or two unsuccessful certified wells on my lease?

(a) Subject to the requirements of §§ 203.40, 203.42, 203.44, and 203.47 and beginning the first day of the month that you file the data and written *(Note: Added for clarification.)* request under § 203.46, you must apply royalty suspension supplements stipulated in § 203.44 to production from, or allocated under an approved unit agreement to, the lease that was the target of your drilling, without restriction on the drilling depth of the well producing the gas or oil.

(b) If you have a royalty suspension volume for the lease under § 203.41, you must exhaust the royalty suspension volume before applying any unused royalty suspension supplement to deep gas production.

(c) If you have no production on which to apply the royalty suspension supplement allowed under § 203.44 when it is earned, your royalty suspension supplement applies to the earliest subsequent production on your lease. Unused royalty suspension supplements automatically *(Note: Added for clarification and the let lessees know no action is require to transfer the unused volumes.)* transfer to a successor lessee and expire with the lease.

(d) You may not apply the royalty suspension supplement allowed under § 203.44 to

production from any other lease, except for production allocated to your lease from an approved unit agreement. If the unsuccessful certified well is on a lease subject to an MMS-approved unit agreement, the lessees of other leases in the unit may not use any portion of your royalty suspension supplement.

(e) You must begin or resume paying royalties when cumulative oil and gas production from or allocated to your lease (excluding any deep gas produced subject to a royalty suspension volume allowed under § 203.41) reaches the applicable royalty suspension supplement. For the month in which the cumulative production reaches this royalty suspension supplement, you owe royalties on the portion of gas or oil production that exceeds the amount of the royalty suspension supplement remaining at the beginning of that month.

(f) If there is more than one lessee on a lease reporting production on the OGOR-A, and subject to the notice requirements under § 203.43 and § 203.46, production first reported and recorded by MMS will be the royalty supplement counted first in reaching the total royalty supplement the lease is entitled to receive. *(Note: This sentence is suggested to cover the contingency of multiple operators on a lease reporting production from different platforms and reservoirs. This will assist in administering the royalty supplement between different operators.)*

§ 203.46 What administrative steps must I take to obtain and use the royalty suspension supplement?

(a) Before a deep well targeted to a reservoir on your lease commences drilling, you must notify, in writing, the MMS Regional Supervisor for Production and Development of your intent to begin drilling operations; and

(b) After drilling the well you must:

(1) Provide MMS with data, including any well test data, that allows MMS to confirm that you drilled an unsuccessful certified well as defined under § 203.0. You must submit this data within 60 days after reaching the Total Depth (TD) in your well to be eligible for the royalty suspension supplement under §203.45; and

(2) Request confirmation that the royalty suspension supplement applies to your lease.

(c) If you commenced drilling an unsuccessful certified well after March 26, 2003 and finished it before **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]**, you must provide the information required by paragraph (b) on or after **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]** and no later than **[INSERT THE DATE 60 DAYS AFTER THE EFECTIVE DATE OF THE FINAL RULE]**.

(d) Should you fail to provide timely notice as provided under this § 203.46, MMS will have the discretion to deny your request for a royalty suspension supplement. *(Note: Added to eliminate any confusion as to what would happen should a lessee fail to timely notify MMS of a pending deep gas well test.)*

§ 203.47 Do I keep royalty relief if prices rise significantly?

(a) You must pay royalties on all gas and oil production for which royalty suspension otherwise would be allowed under §§ 203.40 through 203.46 in any calendar year when the average NYMEX natural gas price exceeds the threshold of ~~$5~~ $7 *(Note: If a threshold will be used, a higher threshold number is suggested.)* per million British thermal units (Btu), adjusted annually from year 2000 for inflation. The threshold price is adjusted by the percentage that the

implicit price deflator for the gross domestic product changed during the preceding calendar year.

(b) You must pay any royalty due under this section, plus late payment interest under 30 CFR § 218.54, no later than 90 days after the end of the calendar year for which you owe royalty.

(c) Production volumes on which you must pay royalty under this section count as part of your royalty suspension volume and royalty suspension supplements.

(d) Your obligation to pay royalties will continue to be suspended even after the threshold price is reached in a previous calendar year subject to § 203.47 (b) above. *(Note: Added to clarify the obligation of lessees in regard to their continuing royalty responsibilities since the proposed procedure is contrary to certain existing royalty relief procedures currently in place in the regulations under 30 CFR Part 203.)*

§ 203.48 May I substitute the deep gas drilling provisions in § 203.0 and §§ 203.40 through 203.47 for the deep gas royalty relief provided in my lease terms?

(a) You may exercise an option to replace the applicable lease terms for relief related to deep gas drilling with those in §203.0 and §§ 203.40 through 203.47 if you have a lease issued:

(1) From a lease sale held after January 1, 2001, and before **[INSERT THE EFFECTIVE DATE OF THE FINAL RULE]**; and

(2) Wholly west of 87 degrees, 30 minutes West longitude in the Gulf of Mexico ~~entirely~~ any portion of which is located *(Note: The word "entirely" was deleted, and the new phrase added to include all leases where any portion of the block is in water depths of 200 meters. Adding this language will allow a few additional leases in the Gulf of Mexico to be subject to potential royalty relief for deep gas drilling. We consider this beneficial and should be included as part of the area being considered for incentives.)* in water less than 200 meters deep, with royalty relief provisions for deep gas drilling.

(b) You may exercise this option by notifying the MMS Regional Supervisor for Production and Development of your decision before **[INSERT THE DATE 180 DAYS AFTER THE EFECTIVE DATE OF THE FINAL RULE]** and specifying the lease and block number.

(c) Once the option is exercised, you must meet all the activity and administrative requirements pertaining to royalty relief for leases eligible for deep gas royalty relief that were issued in an OCS lease sale held before January 1, 2001.

(d) Exercising the option under paragraph (a) of this section is irrevocable. If you do not exercise this option, your original lease terms apply.

§ 203.49 If my lease covers more than one block, is each block covered by the lease eligible for separate royalty relief?

This paragraph applies to any lease that covers more than one block. Each block covered by a lease is eligible for royalty relief provided by §§ 203.40 through 203.48 as if a separate lease covered each block. *(Note: There are a few OCS leases in the Gulf were one than one block is covered by a single lease. This proposed provision allows royalty relief to be allowed for each block under the lease.)*

We appreciate the opportunity to comment on the proposed rule and welcome any further questions you may have on the rule or any of our suggested modifications. Please direct any inquiries to my attention at (504) 592-6726.

Sincerely,

J. Keith Couvillion

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